COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

D.T.E 05-10 / 04-40 / 04-109

WESTERN MASSACHUSETTS ELECTRIC COMPANY

TRANSITION CHARGE RECONCILIATION FILING
STANDARD OFFICE SERVICE RECONCILIATION FILING
DEFAULT SERVICE RECONCILIATION FILING
TRANSMISSION RECONCILIATION FILING

DIRECT TESTIMONY OF DAVID J. EFFRON

On behalf of

THE OFFICE OF THE ATTORNEY GENERAL

June 24, 2005

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I. STATEMENT OF QUALIFICATIONS

Q. Please state your name and business address.

A. My name is David J. Effron. My business address is 386 Main Street, Ridgefield, Connecticut.

Q. What is your present occupation?

A. I am a consultant specializing in utility regulation.

Q. Please summarize your professional experience.

A. My professional career includes over twenty years as a regulatory consultant, two years as a supervisor of capital investment analysis and controls at Gulf & Western Industries and two years at Touche Ross & Co. as a consultant and staff auditor. I am a Certified Public Accountant and I have served as an instructor in the business program at Western Connecticut State College.

Q. What experience do you have in the area of utility rate setting proceedings?

A. I have analyzed numerous electric, telephone, gas and water rate filings in different jurisdictions. Pursuant to those analyses I have prepared testimony, assisted attorneys in rate case preparation, and provided assistance during settlement negotiations with various utility companies.

I have testified in approximately two hundred cases before regulatory commissions in Alabama, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Kansas, Kentucky, Maryland, Massachusetts, Missouri, Nevada, New Jersey, New

York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, and Virginia.

Q. Are you familiar with restructuring and the recovery of transition costs in Massachusetts?

A. Yes. I have presented testimony in several dockets regarding the recovery of transition costs by Western Massachusetts Electric Company and by Fitchburg Gas and Electric Light Company. As a result of having participated in negotiations, I am also familiar with recovery of transition charges by Massachusetts Electric Company, including the former Eastern Edison Company.

Q. Please describe your other work experience.

A. As a supervisor of capital investment analysis at Gulf & Western Industries, I was responsible for reports and analyses concerning capital spending programs, including project analysis, formulation of capital budgets, establishment of accounting procedures, monitoring capital spending and administration of the leasing program. At Touche Ross & Co., I was an associate consultant in management services for one year and a staff auditor for one year.

Q. Have you earned any distinctions as a Certified Public Accountant?

A. Yes. I received the Gold Charles Waldo Haskins Memorial Award for the highest scores in the May 1974 certified public accounting examination in New York State.

Q. Please describe your educational background.

A. I have a Bachelor's degree in Economics (with distinction) from Dartmouth College and a Masters of Business Administration Degree from Columbia University

II. PURPOSE OF TESTIMONY

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the Office of the Attorney General.

Q. What is the purpose of your testimony?

A. I have reviewed the reconciliation filings for 2003 and 2004 by Western Massachusetts Electric Company ("WMECO" or "the Company"). Pursuant to that review, I am proposing certain adjustments to the reconciliation of transition charge ("TC") revenues and costs, standard offer service ("SOS") revenues and costs, and default service ("DS") revenues and costs by WMECO for 2003 and 2004.

Q. Please summarize your conclusions.

A. I am proposing the following modifications to the company's TC reconciliations for 2003 and 2004:

- The calculation of carrying charges on over- and under-recoveries should be modified to reflect the actual combined state and federal income tax rate.
- The calculation of the Prior Spent Nuclear Fuel credit should be modified to assign 100% of the credit to ratepayers.

I am proposing the following modifications to the company's SOS and DS reconciliations:

- Systems, consulting, and litigation costs, treated by WMECO as SOS and DS costs, should be eliminated from the reconciliation of SOS and DS revenues and expenses.
- The Department should reject the Company's proposal to recover prior years' SOS and DS under-collections through the TC reconciliation.

III. TRANSITION CHARGE RECONCILIATION

A. CARRYING CHARGES

Q. Have you reviewed the Company's calculation of carrying charges on the cumulative over- or under-recovered balance of transition costs on Exhibit MJM-3, Page 1?

A. Yes. The Company provided the supporting calculations for its carrying charges in the response to AG1-004.

Q. Are you proposing any adjustment to the Company's method of calculating carrying charges?

A. Yes. In general, the Company's method of calculating carrying charges appears to be appropriate. However, in calculating the net-of-tax balance to which the carrying charge rate is applied, WMECO used a net-of-tax factor of 60% instead of the actual net-of-tax factor of 60.775%. That is, with a state income tax rate of 6.5% and a federal income tax rate of 35%, the combined tax rate is 39.225%, and the complement of this combined tax rate is 60.775%. This is the appropriate rate to use to calculate the net-of-tax balance to which the carrying cost rate should be applied. On my Schedule DJE-1, I have calculated that using a net-of-tax factor of 60.775% rather than the 60% used by the Company increases the carrying charges accrued on the net over-recoveries by $102,000 as of the end of 2004.

B. PRIOR SPENT NUCLEAR FUEL CREDIT

Q. Has the Company included a Prior Spent Nuclear Fuel ("PSNF") credit in the 2004 TC reconciliation?

A. Yes. The Company has included a PSNF credit of $557,000 in the 2004 TC reconciliation.

Q. Can you briefly describe how the Company calculated the PSNF credit?

A. Yes. The PSNF credit results from the Company's refinancing of its PSNF obligation at the end of the third quarter of 2004. The Company calculated the change in the TC net operating income requirement from the elimination of PSNF accrual and then subtracted from that the net of tax interest expense on the debt issued to refinance the PSNF obligation. This difference was then split 50/50 between customers and investors and grossed up to a revenue requirement basis (response to AG1-006). The customer share of the annual PSNF credit was calculated to be $2,228,000. As the refinancing took place ¾ of the way into 2004, the Company reflected ¼ of the annual PSNF, or $557,000, in the 2004 TC reconciliation.

Q. Did refinancing the PSNF impose additional costs on ratepayers?

A. Yes. I show the effect of refinancing the PSNF on my Schedule DJE-2. Prior to the refinancing, the accrued PSNF liability was treated as a reduction to the fixed cost base on which the return included in the fixed cost component of the TC was calculated. Prior to the refinancing, the PSNF obligation in 2004 was approximately $48 million. At the 2004 rate of return of 13.11% (again, prior to the refinancing), this reduction to the fixed cost base reduced the return included in the fixed cost component of the TC by $6.3 million. Interest accrued on the PSNF obligation of approximately $0.5 million is included in the variable component of the TC. Thus, the net effect had been a reduction to the TC revenue requirement of $5.8 million. Therefore, refinancing the PSNF obligation had the effect of increasing the TC revenue requirement by approximately $5.8 million annually, exclusive of the effect of the inclusion of the new debt in the capital structure, which increases the TC revenue requirement even more. This compares to the customer share of the annual PSNF credit of $2.2 million calculated by the Company. The PSNF credit included in the TC reconciliation by WMECO does not come close to making customers whole for the additional costs imposed by the PSNF refinancing.

Q. Is it appropriate to split the difference between the change in the TC operating income requirement and the net interest expense between customers and shareholders?

A. No. Even if the full amount of that difference, approximately $4.4 million annually on a revenue requirements basis, were credited to customers, it would still not compensate them for the increase in the TC revenue requirement caused by the refinancing of the PSNF. Allocating only one-half of the difference to customers exacerbates the increased costs being imposed on customers.

Q. Has the Department explicitly authorized the 50/50 sharing proposed by the Company?

A. In its response to AG1-006, the Company claims that its method of calculating the PSNF credit was approved by the Department in D.T.E. 03-82. In response to AG2-002, WMECO cited certain statements on pages 4 and 17 of the Order in D.T.E. 03-82 as constituting implicit approval of the proposed 50/50 sharing.

The cited statement on page 4 of the Order is simply a description of the Company's proposed sharing. As far as I can tell, it does not imply any approval of that proposal. The cited statement on page 17 notes that the Company has demonstrated that the proposed sharing mechanism will benefit ratepayers in the short term. Clearly, the sharing mechanism does benefit ratepayers as compared to not providing any credit. However, I do not read the explanatory statement on page 17 as constituting approval of the Company's proposed 50/50 sharing of the PSNF credit in the transition charge reconciliation.

WMECO did propose its method of calculating the PSNF credit in D.T.E. 03-82 and the Department did acknowledge the Company's proposal in its Order. The Department did approve the Company's request to refinance the PSNF obligation in D.T.E. 03-82. However, I do not see the Department as having explicitly approved the Company's proposed method of calculating the PSNF credit, especially with regard to the sharing. As far as I can determine, the Company's proposal to split the difference between the change in the TC operating income requirement and the net interest expense between customers and investors has not been approved by the Department.

Q. What do you recommend?

A. The refinancing of the PSNF obligation imposes additional costs on customers. The PSNF credit, as calculated, mitigates the magnitude of the additional costs but does not eliminate them. Even if the full amount, rather than only 50%, were credited to customers, it would still not eliminate the additional costs incurred as a result of the refinancing. In these circumstances, I do not believe that the 50/50 sharing proposed by WMECO is appropriate. The full amount should be credited to customers. Doing so increases the PSNF credit to the variable component of the TC by $557,000, from $557,000 to $1,114,000, in the 2004 TC reconciliation.

IV. SOS AND DS RECONCILIATIONS

A. SYSTEMS, CONSULTING, AND LITIGATION COSTS

Q. Has WMECO included expenses other than payments to suppliers in the reconciliation of SOS and DS revenues and expenses?

A. Yes. The Company has included expenses identified as generation information systems costs, RFP consulting costs, and litigation costs in the reconciliation of SOS and DS revenues and expenses. I have summarized these expenses by year, type of cost, and applicable service on my Schedule DJE-3. As can be seen on this schedule, for the years 2002 -2004 (and the first two months of 2005 for costs applicable to SOS), these costs totaled $1,302,000.

Q. Can you describe what these costs represent?

A. Yes. The generation information systems costs are administrative expenses related to the verification of retail electric suppliers' compliance with green power and environmental regulations. These costs are billed by ISO-NE to responsible market participants such as WMECO (response to AG1-018).

RFP consulting costs are expenses associated with an independent consultant to verify the impartiality of the processes used in the development of requests for proposals to provide standard offer service and default service. The independent consultant was retained pursuant to the order of the Department in D.T.E. 97-120 (response to AG1-018).

The litigation costs are for outside counsel related to legal disputes arising between WMECO and power suppliers in the procurement of SOS and DS. Those disputes have led to litigation and arbitration regarding the terms of the supply contracts, resulting in the litigation costs incurred by WMECO (response to AG1-023).

Q. Are the generation information systems costs, RFP consulting costs, and litigation costs properly includable in the reconciliation of SOS and DS revenues and expenses?

A. No. These expenses are not the actual costs of standard offer service and default service. Rather, they are costs incurred by WMECO as the incumbent distribution utility responsible for providing SOS and DS to its customers. As such, these costs are properly treated as being a component of the distribution administrative and general expense. These expenses should not be included in the reconcilable SOS and DS costs.

Q. What is the effect of eliminating the generation information systems costs, RFP consulting costs, and litigation costs from the SOS and DS reconciliations?

A. As shown on Schedule DJE-3, the effect is to reduce the reconcilable SOS costs for the years 2002-2005 by $1,017,000 and to reduce the reconcilable DS costs for the years 2002-2004 by $285,000.

B. SOS AND DS UNDER-RECOVERED BALANCES

Q. Is WMECO proposing to include SOS and DS under-recovered balances from prior years in the TC reconciliation?

A. Yes. The Company has included the 2001 DS under-recovered balance of $2,924,000 (including interest) in the variable component of the 2003 TC reconciliation. The Company has also included a charge of $5,389,000 to the variable component of the 2004 TC reconciliation, representing the net balance of the 2003 SOS under-collection, the 2002 DS over-collection, and the 2003 DS under-collection, all with interest (Exhibit MJM-3, Page 3).

Q. Are these items properly includable in the TC reconciliation?

A. According to the Company's tariffs, they do not appear to be. The SOS tariff specifies that under-recoveries remaining at the end of the standard offer service period "shall be recovered from all Retail Delivery Service customers by a uniform surcharge not exceeding $0.005 per kilowatt-hour commencing after such period." The DS tariff specifies that any excess or deficiency resulting from the reconciliation of DS revenues and expenses "shall be refunded to, or collected from, all Distribution Company customers on a per kilowatt-hour basis over the following 12 months, with interest, through a Default Service Cost Adjustment Factor." Neither of these tariffs provide for recovery of under-collected SOS and DS balances through the TC reconciliation.

Q. What do you recommend?

A. The Department should reject the Company's proposal to include SOS and DS under-recovered balances from prior years in the TC reconciliation. These under-recovered balances should be recovered by the means specified in the applicable tariffs.

Q. Does this conclude your direct testimony?

A. Yes.